Recent Developments in Charitable Giving and Exempt Organizations

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Topics to be Covered

- Charitable giving provisions of Pension Protection Act of 2006 (H.R.4)
- Supporting Organizations and Donor Advised Funds provisions of H.R.4
- Compliance Check Triggers, Results and Planning
- Hot topics: church political activity; hospitals and community benefit

Charitable giving provisions of Pension Protection Act of 2006

- IRA Charitable Rollover
 - Donors over age 70 ½
 - Directly transfer up to \$100,000 from IRS to
 - Public charity
 - Other than a support organization or donor-advised fund
 - Deduction allowed only for after-tax contributions to IRA

Charitable giving provisions of Pension Protection Act of 2006

- S Corp gifts
 - Charitable contribution of appreciated property
 - Shareholder's basis reduced only by corp's basis in property, not fair market value
- Tangible personal property contributions
 - If to public charity for related use; fmv deduction
 - If charity stops use or sells within 3 years
 - · Donor recapture diff between fmv and basis
 - · Can avoid recapture if charity provides certification to IRS

Charitable giving provisions of Pension Protection Act of 2006

- Gifts of Clothes and Household items
 - Only allowed deduction if in good condition
 - Does not apply to gifts over \$500 where appraisal
- Cash contributions starting in 2007
 - New recordkeeping:
 - only bank records or charity receipt with name, date and amount
 - Notice 2006-110 payroll deductions

Charitable giving provisions of Pension Protection Act of 2006

- Fractional interests
 - Donors of interests in tangible personal property must donate balance no later than 10 years after gift of first interest (or donor's death)
 - If not done, recapture of deductions with interest
 - Limit on value of future gifts to lower of value of property when first gift made or fmv of later gift
 - Before making first gift, all the interests in property must be owned by donor or donor and the charity

Pension Protection Act of 2006 Increase in Penalty Excise Taxes

- For public charities and social welfare organizations,
 - Doubles the maximum penalty under IRC
 Section 4958 on organization managers for participating in excess benefit transactions from \$10,000 per transaction to \$20,000 per transaction.

Pension Protection Act of 2006 Increase in Penalty Excise Taxes

- Self-dealing under IRC Section 4941: Imposed on acts of self-dealing between a disqualified person and a private foundation.
- The Act increases the initial tax on the self-dealer from 5% of the amount involved to 10% of the amount involved.
- The initial tax on a foundation manager who participated in the act of self-dealing knowing it was such an act increases from 2.5% of the amount involved to 5% of the amount involved.
- The Act doubles the maximum penalty on organization managers from \$10,000 per self-dealing act to \$20,000 per self-dealing act.

Pension Protection Act of 2006 Increase in Penalty Excise Taxes

- Excise taxes on self-dealing under IRC Section 4942 are imposed on private non-operating foundations for failing to pay out a minimum amount each year as qualifying distributions.
- The Act increases the initial tax on the foundation from 15% of the undistributed amount to 30% of the undistributed amount.

Pension Protection Act of 2006 Increase in Penalty Excise Taxes

- Private foundations are subject to tax on excess business holdings under IRC Section 4943.
- Prior to the Act, the initial excise tax was equal to 5% of the value of the excess business holding held by the foundation.
- The Act increases the initial tax to 10% of such value.

Pension Protection Act of 2006 Increase in Penalty Excise Taxes

- IRC Section 4944 imposes on private foundations (PF) an excise tax on investments that jeopardize the foundation's charitable purpose.
- Initial tax on the PF is increased by the Act from 5% of the amount of the investment to 10% of the investment. The initial tax on PF managers was also increased from 5% to 10% of the investment.
- The Act doubles the maximum initial excise penalty on organization managers from \$5,000 per investment to \$10,000 per investment.
- The maximum additional tax on PF managers was increased from \$10,000 per investment to \$20,000 per investment.

Pension Protection Act of 2006 Increase in Penalty Excise Taxes

- Certain expenditures, such as grants made without prior IRS approval of the grant-making procedures, are subject to an excise tax under Section 4945.
- The Act increases the initial tax on the foundation from 10% of the expenditure to 20% of the expenditure.
- Under the Act the initial tax imposed on the foundation manager is increased from 2.5% of the expenditure amount to 5% of the expenditure amount.
- The Act doubles the maximum initial excise penalty on organization managers from \$5,000 to \$10,000 of the expenditure amount. The maximum additional tax on foundation managers was increased from \$10,000 to \$20,000 of the amount of the expenditure.

Pension Protection Act of 2006 Miscellaneous Other Provisions

- Qualified appraiser requirements and penalties
- Increase in penalties for valuation overstatements
- Expanded base of the tax under IRC 4940

Pension Protection Act of 2006 Supporting Organizations

- Expanded definition of disqualified person
- Automatic excess benefit transactions
 - Grants, loans, payments of comp to substantial contributors
 - Loans to disqualified persons
- Expanded penalty for automatic excess ben. trans.
- Tax on organization manager doubled

Pension Protection Act of 2006 Supporting Organizations

- Private non-operating foundation grants to SO: meeting 5% payout requirement
 - Type I and Type II and Type III (functionally integrated) it counts
 - Type III (not functionally integrated) must exercise expenditure responsibility
- Private operating foundation; must exercise expenditure responsibility

Pension Protection Act of 2006 Supporting Organizations

- Private foundation grants to SO: meeting 5% payout requirement
- Type I and Type II
 - SO can not be controlled by disqualified person of private foundation
 - Charity that is being supported can not be controlled by disqualified person of private foundation
- Announcement 2006-93
 - Change classification from 509(a)(3) to 509(a)(1) or (2)

Pension Protection Act of 2006 Supporting Organizations

- Type III
 - How to determine type (donor interest)
- New requirement for Type III SO to provide each of supported organization information to ensure responsiveness
- Type III can not have foreign supported organization

Pension Protection Act of 2006 Supporting Organizations

- Notice 2006-109
 - To ensure qualifying distribution treatment under IRC 4942(g)
 - Reliance on IRS Business Master File
 - Good faith representation of charity and specified documents and Publication 78
 - · Opinion of counsel
 - Standards for determining "functionally integrated Type III supporting organization"

Pension Protection Act of 2006 Donor-Advised Funds

- Definition
 - Separately identified by reference to a donor or donors
 - Owned and controlled by a sponsoring organization
 - Advisory privileges
- Exceptions; e.g. distributions to a single identified organization

Pension Protection Act of 2006 Donor-Advised Funds

- Excise taxes on certain distributions are subject to automatic excise tax (Section 4966)
- Excise taxes on prohibited benefits (Section 4967)
- Excise tax on excess benefit transaction to donor, donor advisor or person related to donor

Pension Protection Act of 2006 Form 990 New Notification Requirement

- EOs with gross receipts under \$25,000
 - Annual periods starting after 12/31/06
 - Required abbreviated notice
 - No penalty for failure to file; but continuing failure (3 years) could result in revocation of exempt status
 - For renewed recognition of exemption; new application, whether or not required originally

Compensation Initiative

- Will be asking for:
- How set and report compensation
- Governance body that approve comp
- Details on execs duties and responsibilities
- Loans or sales to execs
- Details insider transactions

Compensation Check Triggers

- Compliance check triggers
 - No answer to questions about transactions between EO and related individuals
 - (Schedule A, Part III)
 - Missing schedule with explanation for receivables from officers
 - (Form 990, Part IV, line 50)

Compensation Check Triggers

- Compliance check triggers
 - Form 990 Question 89(b) -- participation in excess benefit transaction
 - No answer at all
 - "Yes" but no explanation

Compensation Check Triggers

- Examination letter [sometimes follows]
 - Seeks more detailed information
 - Generally single-issue
 - Asks about policies and procedures for setting compensation
 - Duties and responsibilities of officers, trustees and key employees
 - Did EO establish presumption of reasonableness

Compensation Check Results

- Substantial loans to insiders; undocumented
 - March, 2006 new phase dedicated to loans
- Spreading compensation of officers and insiders among several entities
- Payment of excessive compensation for part-time work

Compensation Check Results

- Confusion in reporting deferred comp (DC)
 - DC should be reported as accrued
 - Do not need to report accruals reported in prior years
 - Instructions explain to report DC when paid
 - EO should indicate in footnote, schedule or notes if amount has been previously accrued
 - DC amounts must be reported even if not vested or subject to substantial risk of forfeiture

- Steps to take to ensure Reasonable Comp
 - Meet rebuttable standard of reasonableness
 - Reviewed in advance by disinterested board
 - Decision based on comparability data
 - Documentation of decision in minutes
 - Report benefits to officers, directors and key employees on Form 990
 - If delegate comp determination; disclose to full board

Compensation Planning

- Conflict of interest questions
 - Does board member have financial interest?
 - Is interest material?
 - Is financial interest affected by compensation arrangement?
- Example of conflict
 - EO board member is partner in law firm
 - Conflict exists in negotiating retainer between EO and firm
- No Conflict:
 - if same board member discuss contract with construction firm
 - unless board member has financial interest in construction firm

- Comparables
 - Reasonable compensation: amount ordinarily paid by like enterprises under like circumstances
- Standard: substantially similar duties and responsibilities

Compensation Planning

- Comparables
 - Reasonable compensation: amount ordinarily paid by like enterprises under like circumstances
 - Can come from for-profit
 - IRS view: can not use presumption
 - IRS view: will get increased scrutiny
- Like enterprises
 - Should be same industry
 - Preschool is not same as university

- Standard: substantially similar duties and responsibilities
 - What does person actually do?
 - Hands on vs. policy
 - · National vs. local
 - Number of employees managed
 - Number of departments, facilities, entities
 - Number of hours worked: FT, PT
 - Is there an element for prior services?

Compensation Planning

- Multiple capacities
 - All economic benefits must be aggregated
 - Caution: automatic doubling
 - If comp as director reasonable
 - If comp as officer is reasonable
 - Added together is reasonable?
- Forms of compensation
 - all items should be included unless specifically excluded (i.e. nontaxable fringe benefits)

- Examples of items to include:
 - Personal component of business travel
 - Spouse travel expenses
 - Personal use of EO owned property
- Automatic excess benefit transaction
 - If not clearly indicated as comp for services
 - Deadline to amend return: until time IRS starts an examination
 - Query: is it a compliance check or examination?

Political Activity

- Prohibition on political campaign intervention, includes
 - Any and all activities that favor or oppose one or more candidates for public office
 - Candidate endorsements
 - Contributions to political campaign funds
 - Public position statements: for or against

Political Activity

- Report by IRS (3/06)
 - ¾ of 82 charities participated in prohibited activity
 - Most were isolated incidents
 - 3 exams: recommended revocation of exempt status
 - 1 case: IRS assessed a tax
 - 18 cases no violations

Political Activity

- Comm'r Everson committed to stopping political intervention violations
 - All Saints Episcopal Church (Pasadena, CA)
 - Fact Sheet (FS-2006-17 (2/17/06))
 - Inquiry into NAACP violated rules against campaign intervention
- Why so tough? -- enforcement across the board

Tax-Exempt Hospitals

- Community benefit standard
 - Rev. Rul 69-545
 - IRS Questionnaire 13790 [Compliance Check]
 - Detailed questions regarding compensation
 - Type of community benefits being provided
- Sen. Finance Committee hearing (9/06) Chair Grassley; legislation?
 - Enforcement versus self-policing

Tax-Exempt Hospitals

- Illinois nonprofit hospital denied property tax exemption
 - Provena Covenant Medical Center (9/29/06)
 - Failed to meet standard for property tax exemption
 - Charity care "so seriously insufficient"
 - Question is how to value uncompensated care and underfunding of governmental programs

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